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AZERBAIJAN COMPETITIVENESS AND TRADE (ACT) PROJECT

Distinction between employment and self-employment

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Azerbaijan Competitiveness and Trade (ACT) Project

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1. BACKGROUND

On February 29, 2012 the Azerbaijan Competitiveness and Trade (ACT) project hosted a presentation for Mr. Ali A. Masimli, Ph.D., Member of Parliament and Economic Policy Committee, and Mr. Rovshan Suleyman, Chief Advisor, Department of Economic Legislation, Republic of Azerbaijan Parliament, on tax policy. During the presentation it was requested to provide more detailed information on the distinction between employment and self-employment as this has significant implications in terms of taxation and is a difficult issue faced by all tax administrations.

2. INTRODUCTION

Persons receiving remuneration for providing personal services in an employment relationship are deemed employees. In most cases it is not difficult to determine if it is an employment relationship in which the income recipient performs the work under the employer's instructions and in general on his behalf.

It is also usually not too difficult to determine if it is a relationship between a principal and a self-employed person. Self-employment is characterized by the performers being responsible for their own expenses and risks and performing the activity of an economic nature with the aim of achieving a financial gain.

There are, however, in practice, cases where it is difficult to determine whether the income beneficiary is in an employment relationship with an employer or is a party to a service contract between a principal and a self-employed service provider. In cases of doubt, the decision must be based on an overall assessment of the relationship between the person doing the work and the person for whom the work is performed.

The determination of whether a relation in terms of taxation is an employment relationship or a contract between a principal and a self-employed service provider must be made by the tax authority as there are different tax consequences to be applied.

The following is a list of the criteria that may be relevant when the tax authorities determine whether a work relation is employment or self-employment. It is not possible to identify one simple conclusive criterion so the best way of dealing with this is to issue some guidance to the relevant inspection authorities and instruct them to classify such relations in accordance with the Tax Code.

3. EMPLOYMENT RELATION – CRITERIA

The following are typical elements of an employment relationship between an employee and an employer:

- 1) The principal may set general or specific instructions for completion of the work including monitoring and controlling it to ensure it is performed correctly.

- 2) The income of the recipient is solely or mainly from the same principal.
- 3) The principal and the recipient of the income have an agreement for ongoing work performance.
- 4) The income recipient's working hours are determined by the principal.
- 5) The income recipient is entitled to a period of notice for termination of the contractual relation.
- 6) The remuneration is calculated as is common in employment relations e.g., on an hourly, weekly, bi-weekly, or monthly basis or as commission or performance pay.
- 7) The remuneration is paid periodically.
- 8) The principal is accounting for expenses incurred during or in the execution of the work.
- 9) The remuneration is predominantly net income for the income recipient.
- 10) The income recipient is deemed employed in regards to application of other legislation such as legislation on work health and safety, work relations, legislation on collection of social contributions and the like.

4. SELF-EMPLOYMENT – CRITERIA

The following are typical elements of a contractual relationship between a principal and a self-employed service provider:

- 1) The income recipient organizes, directs, distributes and supervises the work without any other instruction from the principal than that possibly resulting from the given or particular order.
- 2) The principal's obligations to the income recipient are limited to the terms and conditions of the particular order.
- 3) The income recipient is not under the terms and conditions of the order limited in or prevented from performing work for other principals or employers.

- 4) The income recipient is financially liable to the principal for the correct and contractual performance of the work and/or does otherwise undertake an independent economic risk for correct performance of the contractual obligations towards the principal.
- 5) The income recipient has employed staff or contracted sub-contractors to perform the contractual obligations towards the principal and is not limited in his or her selection of staff and sub-contractors.
- 6) The remuneration is paid after issuance of invoice and full payment will not be made before the work is performed as agreed and any deficiencies corrected.
- 7) The income recipient obtains income from several and/or changing principals.
- 8) The income depends on the profit of the economic activity.
- 9) The income recipient owns the tools, machines, vehicles and other equipment needed and used to perform the contractual obligations towards the principal.
- 10) The income recipient in whole or in part supplies the materials needed for the work.
- 11) The income recipient has his/her own premises such as a shop, a workshop or garage, office or storage facilities, a clinic, a studio, etc., and the work is wholly or partly carried out from that location.
- 12) The income recipient's occupation requires a special authorization or license and the person has such a permit to perform his or her occupation.
- 13) The income beneficiary indicates towards the public by means of advertising, signs or similar display that he or she is capable of and does undertakes to perform work of a given type or nature.
- 14) The income beneficiary meets the compliance requirement under the tax and social contributions' legislation for persons performing economic activities as independent/self-employed entrepreneurs or sole proprietors.
- 15) The income beneficiary is responsible for the consequences of any accidents happening during the work.

5. DISTINCTION

None of the above criteria pointing towards a relationship of employment or self-employment respectively is in itself conclusive when the tax official makes the

determination during the course of his or her duty whether it be in the course of an inspection or audit or upon being asked about by taxpayers or other members of the public.

The stated elements are also not equally important in all situations. In practice it may be that certain aspects of a relationship between an income recipient and a principal points toward considering the relationship as employment while other aspects points towards classifying it as provision of services by an independent/self-employed contractor. In such cases the decision of the tax official must be based on a general assessment of all aspects of the relationship between the income recipient and the principal with the main emphasis on the facts of the situation and less on the formal papers if those papers do not reflect the realities of the relationship between the parties.

It is the relationship between the income recipient and each of his or her principals that must be classified. If an income recipient has more principals some relations may be employment and others self-employment.

6. LABOR HIRE

There is nothing in the tax legislation preventing labor hire, where a labor hire company against a fee lets its clients use its staff. In this situation the employment relation will be between the staff member and the labor hire company while it will be a contract on providing services between the labor hire company and the client. However, as in any relation, a contract is only relevant if it covers reality and it may be considered that the employment relationship is between the client and the staff member directly if it in reality carries all the characteristic of being an employment relationship.